INTERNATIONAL MONETARY FUND
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IMF Completes Sixth and Final Review Under the Stand-By Arrangement for Iceland

The Executive Board of the International Monetary Fund (IMF) today completed the sixth and final review of Iceland's economic performance under a program supported by a Stand-By Arrangement (SBA). The completion of this review enables the immediate disbursement of an amount equivalent to SDR 280 million (about €312.4 million, or US$450.6 million), which would bring total disbursements under the program to an amount equivalent to SDR 1,400 million (about €1.56 billion or US$2.25 billion).

This is the last review under the SBA, which will expire on August 31. Owing to strong implementation by the authorities, the Fund-supported program has been successfully completed. The objectives have been met and the country is on the road to recovery.
The authorities and staff agreed to ease the pace of fiscal consolidation, given the strong fiscal adjustment to date, the favorable public debt dynamics, and the need to support the recovery. The fiscal target for 2011 was also modestly eased. It is now critical that the revised plan is implemented.

The Central Bank has appropriately raised policy rates, reflecting inflation risks going forward, the fall in real interest rates, and the need for a gradual normalization as capital controls are lifted. The initial steps of the capital account liberalization strategy are being implemented. The pace of restructuring private debt finally appears to be accelerating, but efforts must continue until the end of the process. Recapitalization of Iceland's core banking system has been completed. Work on reducing remaining vulnerabilities and strengthening prudential regulations and supervision is ongoing, and efforts should be sustained. Financing assurances are in place, and Iceland's Nordic and Polish partners have extended their lending facilities until end-2011.

Of course, challenges remain. While moderate growth is expected in 2011, unemployment remains high and inflation is rising on the back of high commodity prices. And strong policy implementation will continue to be essential to fully restore confidence and underpin the recovery.

After the expiration of the SBA, Iceland and the IMF will continue to maintain a constructive policy dialogue. In accordance with Fund policy, Post-Program Monitoring[1] (PPM) will now be initiated.

The 33-month SBA was approved on November 19, 2008 (see Press Release No. 08/296) for an amount equivalent to SDR 1.4 billion and was subsequently extended to August 31, 2011 (see Press Release No. 10/156). The arrangement entails exceptional access to IMF resources, amounting to 1,190 percent of Iceland's quota.

Following the Executive Board's discussion, Ms. Nemat Shafik, Deputy Managing Director and Acting Chair, stated:

"Iceland has successfully completed its Fund-supported program. Key objectives have been met: public finances are on a sustainable path, the exchange rate has stabilized, and the financial sector has been restructured. Strong policy implementation has underpinned this success.

"Remaining uncertainties and risks, including from the external environment, are weighing on the recovery. Further delays to investment projects and an acceleration of inflation may weaken current prospects. Improved prospects would support Iceland's recovery and bolster confidence.

"Fiscal adjustment must continue, but there is some scope to ease the pace of consolidation on account of the significant fiscal effort to date and strong track record. The revised fiscal path would still deliver sustainable debt dynamics, while providing near-term support to the economy. However, it will be critical that the authorities fully implement the new path to ensure that credibility gains are not eroded.

"The first steps of the capital control liberalization strategy are being implemented. Liberalization should proceed gradually and flexibly, while maintaining stability in the government bond market and financial sector and ensuring an adequate level of reserves. Effective enforcement of the capital controls will be essential.

"The tightening bias in monetary policy is appropriate. The rise in inflation expectations and the risks of second round effects from higher wages call for vigilance.

[1] The central objective of PPM is to provide for closer monitoring of the policies of members that have substantial Fund credit outstanding following the expiration of their arrangements. Under PPM, members undertake more frequent formal consultation with the Fund than is the case under surveillance, with a particular focus on macroeconomic and structural policies that have a bearing on external viability.

"Recapitalization of the core financial system marks an important milestone in Iceland's emergence from crisis. Progress in private sector debt restructuring is welcome. However, a further strengthening of financial sector supervision is needed. Addressing remaining vulnerabilities, as well as gaps in the legal, regulatory, and supervisory framework, will be essential going forward. Fully implementing the agreed reforms will be critical to reduce risks and vulnerabilities in Iceland's financial sector."